BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF INTEGRATED RESOURCE PLANNING FOR THE PROVISION OF STANDARD OFFER SUPPLY SERVICE BY DELMARVA POWER & LIGHT COMPANY UNDER 26 DEL. C. § 1007(c) & (d): REVIEW AND APPROVAL OF THE REQUEST FOR PROPOSALS FOR THE CONSTRUCTION OF NEW GENERATION RESOURCES UNDER 26 DEL. C. § 1007(d) (OPENED JULY 25, 2006)	)	PSC DOCKET NO. 06-241

Reply Comments on Draft Report of Jeremy Firestone and Willett Kempton
2 October 2006

These reply comments concern the alleged "Staff Report" (including the redline version of RFP and associated documents) on Delmarva Power and Light's draft request for proposals (RFP) for the construction of new generation resources within Delaware. Consistent with Robert Howatt's email of September 28, 2006, we reserve the right to submit further comments on the redline RFP and associated documents until October 6, 2006.

The Consultant Report

The Commission, in Order, No. 7003 (August 8, 2006) ordered that "the Commission Staff, after consultation with the retained consultant, shall submit a Report with its recommendations concerning modifications, if any, to the Request for Proposals solicitation submitted by Delmarva Power & Light Company" on or before September 15, 2006. Rather than making it own recommendations after consulting with the private consultant, and filing its own timely report as required by the Commission, the Commission Staff filed the private consultant's report. Thus, the Commission's staff did not comply with its own Commission's order. Further, it was not until September 27, 2006, that the Commission Staff first made available to the public copies of a redlined version of the RFP, including its terms and conditions, which, like the Report, were prepared by a private consultant rather than Commission staff. The private consultant's report and redline version of the RFP are purported to have been prepared not only for the Commission staff, but for the Delaware Office of Management and Budget, the Delaware Energy Office, and the Delaware Controller General, but there is nothing to suggest that these entities endorse the conclusions in the report or the redline RFP and adopt them as their own. Moreover, the Commission staff lacks the authority to make such a delegation of authority to a private entity.

Consultant Report Compared to Draft DELMARVA RFP

The private consultant's report, and the redline version of the RFP, is an improvement over the Delmarva RFP in some respects in that they clarify a number of issues (e.g., offshore projects

making landfall in Delaware are allowed), addresses in part some concerns (e.g., over project size and capacity factors), and reallocates some weighting points (e.g., from 7 points assigned to environmental compatibility to 14 points for avoidance of environmental impacts), However, for the most part, the private consultant's report rubber stamps the "business as usual" approach taken by Delmarva. And most disturbing of all, in other respects, it is a further retreat from the law this Commission is required to implement (weights that are even further from the mark than Delmarva's and in essence the wholesale abandonment of the principle criterion established in the law—price stability). In doing so, the private consultant has fundamentally failed to account for the change in the business climate (drastic rate increases for Delmarva's customers), the global climate (e.g., it makes compliance with future environmental costs a pass through and only mentions the RGGI once in a passing reference to a another participant's comment), the legislative directive (a combined less than 30 points out of a 100 total points to the two main concerns of the Legislature (price stability and reductions in environmental impacts), and public comments (brushing aside citizen comment without analysis). As such, the private consultant's analysis suffers even more than Delmarva's out-dated and unlawful approach to the RFP process.

The importance of price stability in HR6

Traditional ratemaking and power contracts allocate very high importance to the price of electricity, and often offer short–term contracts from merchant generators. Due in part to unanticipated very high fuel prices (along with earlier legislation that did not anticipate these price changes and other factors), the price of electricity rose steeply in Delaware. The Legislature's concern and the public's reaction to an unanticipated steep rise in electricity rates were important motivations for the bill. Thus, the reason for HR 6's emphasis on price stability rather than price is that prior system, which relied on price as a primary criterion, had failed.

What would result from continuing the reliance on price in the draft? It would result, for example, in making more likely that a bid for pulverized coal would win over IGCC coal, or that IGCC coal without carbon separation and capture would win over IGCC with it, or that a carbon-producing electricity source would win over sources like offshore wind. In each of these examples, the winning technology would be lower cost at the time of the bid, and with long-term fuel contracts, could be shown on paper to have lower price during the contract period <u>given current conditions.</u> However, the Commission Staff knows that these conditions will not persist.

For example, California has already alerted regional markets that it will buy no new power that produces significant CO_2. This warning to power suppliers and potential power suppliers is already leading to the cancellation of planned coal power plants in Nevada and Arizona, which have traditionally supplied power to California (New York Times, 15 Sept 2006). Such actions would affect power plants in Delaware if either the State of Delaware, or neighboring states, or the PJM Interconnect adopted similar polities. Such restrictions can already be anticipated because, Maryland, Virginia and New Jersey, and even more so Delaware, are likely to be damaged far more than will California (land inundation, loss of shellfish, hurricane intensity, etc) from climate change. The current regulatory environment of unregulated CO_2 emissions is extremely unlikely to persist even as long as the year in which the plant would open, and few utility analysts, if any, would expect that it to continue throughout the time of a long-term contract. Thus, a bidder offering a CO_2-emitting source, or emitting other pollutants whose

regulation also can be expected to change, must contractually agree to cover all future regulatory and tax changes. Otherwise, it would not achieve price stability.

Whether the state or the region or the country changes CO_2 regulation, add carbon taxes, or prohibits new CO_2 producing sources outright—all of which are already happening in other jurisdictions, all these would lead to substantial price increases over the life of the power purchase agreement. Anticipating this, the legislature passed HR6, which gives priority to price stability, environmental impact, and new generation technology. To use price and to essentially eliminate the criterion of price stability, invites decisions today that will lead to sharp price increases in the future, exactly what HR 6 was trying to prevent.

The Unlawful use of Price

Our earlier comments (Firestone and Kempton, 2006-1) argued that the allocation of points to "price," is improper, but the private consultant failed respond and address the substance of those comments. Instead, the private consultant put forth its personal belief that the "Legislature was interested in fostering price stability but at a reasonable price." The private consultant came to this conclusion by erroneously equating the term "cost-effective" with "reasonable." The private consultant then transformed "reasonable" into the "lowest expected price." As we noted in our initial comments, the Legislature used "cost-effectiveness" in reference to meeting the five criteria under which it directed the proposal be evaluated. The Legislature, contrary to the personal "beliefs" of the private consultant, no where stated, let alone suggested, that a proposal's benefits be weighed against the cost of that proposal and that a proposal only would be approved by the Commission if the Commission determined the costs of a proposal were "reasonable." While it is true that law also indicates, as the private consultant noted, that "desired proposals are ones that should result in … '*long-term* system benefits'—including environmental benefits and fuel diversity—'in the most cost-effective manner,'" this does not mean the price is included as a criterion. Again, as we noted in our earlier comments, the Legislature clearly knew how to include price as a criterion if it wanted to—that is, explicitly. The fact that it did not cannot be changed by the wave of a private consultant's magic wand, let alone by the Commission, as it would be violate the bedrock principle of separation of powers. Any complaints with the standards that the Legislature imposed should be directed to the legislature, and not to this Commission, and certainly not, at the behest of a private consultant.

The statement quoted implies a balancing of the five criteria as we mentioned earlier, or at most, to the extent that two projects will provide comparable long-term system benefits (e.g., if two comparable IGCC plants were proposed, or alternatively, two comparable offshore wind projects were proposed), the one that will provide those benefits at the lowest cost, would be cost-effective. In other words, as between projects that are equally effective, the cheapest one is preferred. In that regard, it is important to note that the Legislature did not use the term "cost-benefit" or "cost-efficient" which arguably would have implied that all projects would be compared against one another on the extent to which their benefits exceeds their costs.

Rather than follow the Legislature's lead and eliminate price in favor of price stability, the private consultant compounds Delmarva's error and further elevates the unlawful price criterion, by not only repeating Delmarva's mistake of assigning price the most points, but by elevating price to the dominant factor in one of the private consultant's so-called "super categories."

The Unlawful Gutting of Price Stability and Failure to Acknowledge the RGGI

While the private consultant mentions the RGGI in passing, the private consultant did not address, let alone mention, our argument that Criterion 2 (reductions in environmental impact) and subcriterion b (long-term environmental benefits) must be read *in pari materia* with the RGGI and the RPS and that the allocation of weights must reflect these important state policies. We thus once again ask that our comment be so-considered. Moreover, the ***RGGI, like viability, should be a threshold criterion.*** By this we mean that no project should be selected if its operation will result in the emission of any CO_2 unless the project will displace equivalent emissions from electrical generation (that would not have to retire for other reasons) and the quantity of CO_2 emitted will be less than that emitted by the displaced generation.

Rather than address the RGGI and greenhouse gas emissions, the private consultant gives a pass—literally—to the bidders that generate greenhouse gas emissions and other pollutants. Buried deep in the terms and conditions, the Delmarva RFP provided that the "*Seller … will be responsible for complying with all applicable requirements of law… whether imposed pursuant to existing law or pursuant to changes enacted or implemented during the contract term, including all risks of environmental matters….*" To this, the private consultant has added:

> ***Notwithstanding the foregoing, in the event that a change in law occurs which imposes future environmental compliance costs in the form of a Btu or carbon tax, Seller and Buyer shall treat the tax as a "pass through" addition to the cost of energy under the Definitive Agreement.***

In this one sentence, the private consultant has completely eviscerated the principal concern of the Legislature—price stability and somewhat ironically, the private consultant's own emphasis on low price. It is truly an Orwellian world where price stability and low price is attained, but only at the expense of passing price increases on to the public under a different name. It is not clear who the private consultant is looking out for, but it certainly is not Delmarva ratepayers.

This change in the terms by the private consultant is so drastic and fatal that one might overlook the fact, that in the redline version the private consultant decreased from 20 points in the Delmarva RFP and 20 points in its own initial report the points assigned to price stability—the principle legislative criterion—to 15 points. No explanation is given for this action; let alone has the private consultant provided an adequate explanation why the criterion should only be assigned 20 points. (Oddly, the private consultant assigned the 5 points to exposure and refers the reader to section 2.3.8, but then the private consultant deleted all of the language under this section).

The Failure to Respond to Other Comments

Nor did the private consultant address our argument that weighting price six times (now about three times) as much as the reduction in environmental impact and eight times (now more than twelve times) as much as new or emerging technology is improper because price is in conflict with these factors. Indeed, it should come as no surprise that reducing environmental impacts cost money, yet the private consultant's preferred allocation to price would dwarf these factors. Moreover, the private consultant weighs viability (e.g., operation date and certainty, site development, bidder experience, and project financeability) at a cumulative 18 points, which is

more than the points that can be awarded under reduction in environmental impact and weights that combined factor six times as much as innovative technology. While no one is arguing that a bid should be accepted that is not viable, bid viability should be used solely as threshold requirement that eliminates unfeasible bids. It should then not further enter the point allocation as it may end up skewing the bid selection.

Contract Size

We support the recommendation to increase the project size to 400 MW. While the private consultant acknowledged that projects do not have a 100% capacity factor, it is not clear whether the 400 MW figure was the average energy limit to be delivered on average to Delmarva or a capacity limit. We believe strongly that whatever project size is ultimately selected it should be an energy limit to account for differing capacity factors of different means of generation. We also do not understand the private consultant's reference to the Cape Wind plant as if that Massachusetts plant determined sizing under this RFP. Whatever the size of the proposed Cape Wind project, is immaterial to the decision for Delaware. Thus, if, for example, a 900 MW offshore wind plant would provide more benefits for the cost than a 400 MW plant, the developer should have the option of proposing the 900 MW project (@ 40% capacity factor, it would be equivalent to 100% capacity factor 360 MW plant, and thus under the 400 MW limit). Similarly, a 500 MW IGCC coal plant, with an expected 75% capacity factor, would generate the energy equivalent of 375 MW and be under the size limit.

Exposure Category

Proposed projects that will generate more energy than contracted for by Delmarva may send power out-of-state. These projects thus have the potential to power non-Delawareans yet generate environmental and human health impacts on Delaware and its residents. Project that expose Delaware and its residents to those impacts should be disfavored in the evaluation process.

Conclusion

We thus respectfully request that (1) the Staff (in consultation with the consultant) respond and address our arguments here and in our earlier comment rather than merely having its consultant acknowledge that comment have been made; (2) that price be deleted as a criterion; (3) that future costs and restrictions on carbon emissions shall explicitly be the responsibility of the bidder, not be passed on to Delmarva or the ratepayers, (4) that weightings be established consistent with HR6; and (5) that the RFP be amended accordingly.

Respectfully submitted,

Jeremy Firestone
Willett Kempton

2 October 2006